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SUBJECT: THE FUTURE OF THE U.S.-JAPAN INVESTMENT INITIATIVE

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¶1. (SBU) Summary: The U.S.-Japan Investment Initiative recently completed its eighth year of work on improving Japan's investment climate and contributing to economic growth in both countries. The Initiative can claim a number of successes. However, we may be able to engage Japan more effectively to open to foreign investment -- and the trade flows and U.S. domestic job creation associated with such investment -- and to work jointly for stronger investment regimes in the region, if we enhance bilateral investment-related discussions. End Summary.

Past Success of U.S.-Japan Investment Initiative

¶2. (U) The U.S.-Japan Investment Initiative and its associated bilateral Investment Working Group have, since their establishment in 2001, achieved concrete improvement in Japan's investment climate and raised the awareness among GOJ officials of the contribution of cross-border investment flows to long-term economic growth. Japan's stock of FDI over the lifetime of the Initiative tripled from 6.1 trillion yen to over 18 trillion yen (about USD 180 billion at current exchange rates.) Meanwhile, both U.S. investors and Japanese companies have benefited from the increasingly important role of foreign capital in Japan's equity markets. Foreign investors are a major force in Japan's capital markets owning approximately 27 percent of Japan-listed equities (compared with less than five percent 20 years ago), and accounting for between 50 and 60 percent of the daily trading volume of the Tokyo Stock Exchange. Business representatives and academics also consistently note that success in opening Japan to greater foreign investment yields benefits in terms of opening Japan generally to increased economic engagement, to further economic reforms, and to more trade with the United States.

Investment Issues Remain Salient

¶3. (U) Investment liberalization and opportunities for merger and acquisition (M&A) activity in the Japanese market continue to interest U.S. businesses. The American Chamber of Commerce in Japan (ACCJ) remains a vocal advocate of expanding the types of cross-border M&A transactions allowable under Japanese law and of introducing global standards of corporate governance to Japan-listed companies

as a means of improving their financial efficiency. ACCJ has issued five "Viewpoint" position papers on subjects related to corporate governance since the beginning of 2008. Officials from U.S. companies -- both manufacturing as well as financial services firms -- also repeatedly emphasize that trade, with benefits in terms of increased U.S. exports and the creation of U.S.-based jobs, follows U.S. investments in Japan.

¶4. (U) Investment issues are also of continuing interest to the Japanese government. The government's official goal of doubling Japan's stock of foreign direct investment (FDI), as a percentage of GDP, by the end of FY2010 (March 2011) remains in place. Although, at present, there is a lack of cabinet-level policy direction in this area, working level officials at the Ministry of Economy, Trade and Industry (METI) and the quasi-governmental Japan External Trade Organization (JETRO) continue to actively promote inward FDI. The Financial Services Agency (FSA) is implementing policies to make Japan's capital markets more attractive to foreign investors.

Benefits from Combining Discussions into Single Forum

¶5. (SBU) Embassy Tokyo believes there would be benefits from a more coordinated approach to all current investment-related bilateral activities. While we do not propose a particular format or level for these discussions, we believe there is a critical mass of issues surrounding investment policy that are ripe for progress with Japan over the next several years. The Investment Initiative in recent years has been discussing liberalization of cross-border merger techniques, policies governing national security reviews of proposed FDI transactions, Japan's obstacles to foreign investment in educational services, and GOJ and USG strategies towards negotiating bilateral investment treaties (BITs) with third countries. Separately, the Regulatory Reform and Competition Policy Initiative discusses corporate governance issues and regulations to strengthen protection of minority shareholder rights. The Financial Services Working Group has reviewed tax policies that may have an impact on investment. Discussion on multilateral and regional investment policy largely takes place in APEC working groups. All of these issues remain relevant to U.S. companies operating in Japan.

¶6. (SBU) Private sector interest in these issues, however, is moving beyond simply seeking improvements to Japan's regulatory structure and in the direction of a more comprehensive policy approach to improving the investment climate. This includes issues such as tax policy, the role of independent directors on company boards, and Japan's climate for entrepreneurship and innovation. At the May 2009 Investment Working Group session, the METI co-chair expressed interest in continuing an investment dialogue with the U.S. and the two sides had a preliminary discussions on how we might link our bilateral investment discussions to related activities in multilateral organizations such as APEC and OECD.

Policy Objectives for an Expanded Investment Dialogue

¶7. (SBU) The policy objectives of an expanded investment dialogue would be to:

-- Promote investment as a positive contribution to the global economic recovery;

-- Respond to the concerns of U.S. businesses about continued legal and regulatory obstacles in Japan to cross-border investment flows;

-- Promote needed Japanese domestic structural reforms; and

-- Contribute to improved regulatory transparency and corporate governance in Japan.

Outline of an Enhanced Investment Agenda

¶8. (SBU) Possible items for an enhanced investment agenda could include:

-- Improving Japanese Corporate Governance by encouraging an expanded role for independent directors on corporate boards, limiting cross-shareholding linkages between operating companies without explicit approval of shareholders, and strengthening minority shareholder rights;

-- Seeking changes to Japan's Company Law to expand the allowable structures for M&A;

-- Promoting increased regional autonomy in Japan and empowering local governments so they can provide targeted incentives to potential investors;

-- Exploring ways to promote innovation and entrepreneurship and support corporate start-ups;

-- Removing disincentives to corporate reorganization (an issue first raised by Japan at the May 2009 working group);

-- Expanding U.S.-Japan cooperation to oppose investment protectionism and promote investment liberalization and investor protection schemes in third countries;

-- Tax issues, including Japan's high corporate tax rates and the lack of effective tax deferral for cross-border stock swaps.
ZUMWALT